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SUBJECT: State Steps in to Ensure Bank Consolidation in Germany

Ref: 08 Frankfurt 2735

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¶1. Summary: Both Deutsche Bank and Commerzbank are speeding up efforts to complete takeovers despite deteriorating balance sheets and losses in the fourth quarter. Finance Minister Steinbrueck has taken a firm position in favor of consolidation, stepping in to assure that the deals go through in the hope of warding off bank failures. In both merger cases the state will assume ownership stakes in the new entities, ultimately putting tax payer money on the line if share prices do not recover. Steinbrueck and his colleagues in the Grand Coalition also seem motivated to create larger financial institutions that can help the German economy stay competitive globally. End Summary.

Commerz and Deutsche Restructure Takeover Deals

¶2. Commerzbank, Germany's second largest bank, received an additional 10 billion euro ($12.9 billion) capital injection January 8, giving the German state a 25% stake in the bank. Coming on top of the 8.2 billion euro ($9.84 billion) injection received two months ago, the capital enabled Commerzbank to complete its takeover of Dresdner Bank last week. Minister of Economics Michael Glos (CSU) denied that the aid constituted a nationalization, maintaining that the government will sell back its shares when their value increases, but for now the government will have two seats on the supervisory board. (Note: Commerzbank had renegotiated the purchase from Allianz in November, speeding up the takeover, but paying more in shares and less in cash, thereby lowering the overall sale price. Commerzbank has since announced it lost money in the fourth quarter of 2008.) In a recent speech, CEO Martin Blessing defended the takeover arguing that he had not expected a further deterioration of the financial markets when the original deal was announced in August.

¶3. It is also expected that Germany's largest bank, Deutsche Bank, will restructure its deal to purchase 30% of Postbank from Deutsche Post, also offering shares instead of capital and lowering the sale price. If the deal goes through, Deutsche Post could own as much as 8% of Deutsche Bank, making the state, which partly owns Deutsche Post, an indirect owner of Deutsche Bank. Deutsche Bank will also have the right to purchase a larger share of Postbank within three years. The likely restructuring reflects Deutsche Bank's own difficulties coming up with capital after announcing a 4.8 billion euro ($6.2 billion) fourth-quarter loss, and an annual loss of 3.9 billion euros ($5 billion) for 2008.

¶4. In both cases, the sellers have shown a willingness to accept poorer sales conditions in order to keep the deals alive. The sale price of Dresdner and Postbank will end up much lower than originally announced, while the shares received in Commerzbank and Deutsche Bank as payment continue to plummet. However, the sellers

have little choice as banks must hold on to precious capital in an environment where a strong capital to assets ratio is the only way to maintain investor confidence.

Government Looks to Create Bigger Banks

¶5. Finance Minister Peer Steinbrueck has expressed strong support for the Commerz-Dresdner deal saying: "I think there is no alternative to a bigger concentration of the German banking sector as this is needed to remain competitive and fully reap the benefits of international capital markets. The combination of these two institutions is clearly in the interest of Germany as a financial centre." Christoph Swonke, an economist at the German Council of Economic Experts, explained to Econ Off that Steinbrueck and other senior politicians have long wanted to create larger German banks that can better help industry and business compete globally and have taken advantage of recent turmoil to achieve this goal. Germany's financial landscape is relatively dispersed, with no German bank among the world top ten in 2008 as measured by market capitalization. Swonke argued that politicians would not say explicitly that they hoped to create "national champions" as that term implied a strong role for the state in the economy (which goes against both EU and domestic policy positions), but the drive for mergers was in effect this phenomenon in all but name.

¶6. Deutsche Bank Economist Bernhard Speyer echoed the point saying that as large international banks like Fortis and Royal Bank of Scotland reduce their lending in Germany due to their own difficulties, it would be all the more imperative to have large domestic banks that could provide funding to both large and small enterprises. (Note: The current credit crisis has hit large

enterprises harder than smaller, as banks are unable or unwilling to come up with the significant long-term funding such entities require; thus the vitality of large German banks is more critical than ever.) Speaking at a roundtable discussion in Frankfurt January 15, European Central Bank board member Juergen Stark criticized the German government moves, saying that the state was taking on real risks that would fall to the taxpayer should share prices not rebound.

Comment

¶7. As the credit crisis worsened, Commerzbank's takeover of Dresdner became "the right deal at the wrong time" and only state intervention kept it from failing. The government now finds itself a part owner of Commerzbank, likely soon of Deutsche Bank, and possibly of much maligned Hypo Real Estate if it continues to stumble. In these cases however, Steinbrueck appears to see intervention as worth the risk not only to stabilize the financial system, but also to bring about the consolidation in the industry which he has long supported. End Comment.

¶8. This cable was coordinated with Embassy Berlin.
POWELL